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C O N F I D E N T I A L SANTIAGO 000976

SIPDIS

TREASURY FOR SSENICH  
STATE PLEASE PASS TO FEDERAL RESERVE TOM CONNORS  
COMMERCE FOR KMANN  
STATE PLEASE PASS TO USTR KATE DUCKWORTH  
STATE FOR WHA/BSC, WHA/EPSC, EEB/IFD/OMA

E.O. 12958: DECL: 10/30/2018  
TAGS: [ECIN](#) [ECON](#) [EFIN](#) [EINV](#) [ETRD](#) [PGOV](#) [PREL](#) [CI](#)  
SUBJECT: CHILEAN CENTRAL BANK PRESIDENT DE GREGORIO UPBEAT  
ON ECONOMY, ASKS FOR U.S. STATEMENT

REF: SANTIAGO 960 AND PREVIOUS

Classified By: AMBASSADOR PAUL E. SIMONS. REASON 1.4 (B) AND (D)

SUMMARY

1. (C) Chilean Central Bank Governor Jose De Gregorio told Ambassador Simons October 29 he is optimistic about the state of the Chilean economy in the face of the global financial turmoil, noting liquidity was not an issue for Chilean banks and the GOC would not need assistance from international financial institutions. De Gregorio said the Central Bank had no plans to prevent the Chilean Peso,s depreciation. He expected around 4% GDP growth in 2009 and noted the Chilean private sector had very little debt denominated in foreign currency. De Gregorio also provided some political analysis following the recent municipal elections in Chile. Post supports De Gregorio,s request for a positive, public statement in support of Chile,s economic management. End Summary.

2. (U) The Ambassador called, at his request, on Chilean Central Bank Governor Jose De Gregorio, to review the current state of Chile,s economic and financial stability, in light of the global financial crisis (reftels). The Ambassador was accompanied by Senior Econoff.

Chile: The Economic &Hope8 of the Americas

3. (C) De Gregorio emphasized he was &highly optimistic8 about Chile,s ability to weather the current financial turmoil. He believed Chile had a well developed and diversified economy (&more liberal in some ways than the U.S. economy8), strong democratic institutions, a government committed to fiscal discipline, independent monetary policy, and significant reserves. The only thing lacking was a sophisticated financial system. The Ambassador noted this was due in part to Chile,s small size. De Gregorio said Chile was in some ways the &hope8 of Latin America. He believed the global crisis would impact Chile the least among countries in the region. This could reinforce the lesson that open market-economies and wise investment, trade, and fiscal policies (i.e., the Chilean model) were the key to sustainable growth.

Liquidity Is Adequate In Banking Sector

14. (C) In response to the Ambassador's question on the state of liquidity in Chile's banking sector, De Gregorio said the system was functioning well. Contrary to some public speculation, international banks had not cut any lines of credit to Chilean banks, even during the tensest weeks at the beginning of the recent financial turmoil. Most banks were still able to borrow at LIBOR 150 basis points on international markets. The Central Bank was offering weekly currency swaps of up to \$500 million (for a term of 60 to 91 days) to Chilean banks at approximately LIBOR 100 basis points, plus appropriate collateral. De Gregorio thought most banks did not need the swaps. Of the initial four auctions (a total of \$2 billion), banks had only opted to take \$780 million. Of the total amount of \$5 billion authorized for this program, De Gregorio opined that only \$1 billion would be actually drawn down by Chilean banks by the end of calendar 2008.

15. (C) The Ambassador noted that Finance Minister Andres Velasco had recently said Chile supported the IMF's new, unconditional liquidity facility for countries impacted by the financial crisis, but that Chile would not need the credit. De Gregorio agreed Chile would not need help from the IMF or other international financial institutions.

#### De Gregorio Requests U.S. Statement

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16. (C) De Gregorio recognized that it would be difficult for Chile and other countries to participate in the upcoming G-20 meeting. He also acknowledged that Chile had no immediate financial requirement for a swap line with the U.S. Federal Reserve. However, Chile had performed in an exemplary

fashion and its record should be recognized in some way. De Gregorio specifically requested some public statement from a senior Treasury or Federal Reserve official, which would recognize Chile's positive handling of the global financial crisis and its clear eligibility (if not need) for a swap line similar to those provided to Brazil and Mexico. Ambassador Simons agreed to pass on this request to U.S. authorities.

#### Central Bank Willing To Let Exchange Rate Float

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17. (C) De Gregorio said the recent decline of the Chilean Peso against the U.S. Dollar (from approximately 553 to 677 in the month of October alone) was way out of equilibrium.<sup>8</sup> However, the Central Bank had no current plans to intervene. When asked by the Ambassador if there was an exchange rate at which the Central Bank would feel compelled to act, De Gregorio dodged the question, but implied the Peso would be allowed to continue depreciating further. He also noted Chile now had the highest real exchange rate with the U.S. Dollar in 25 years. The Ambassador asked about the impact such a marked depreciation would have on inflation. De Gregorio doubted it would create additional inflationary pressures, but acknowledged Chile could not take full benefit from the recent fall in commodity prices as a result of the current exchange rate.

#### Mixed Impact On The Real Economy

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18. (C) Ambassador Simons noted he had recently met with fruit exporters who were pleased that their competitiveness had been enhanced by the recent depreciation of the Peso against the Dollar. De Gregorio acknowledged much of the export sector was doing well. However, the construction industry had been hit hard as a result of the financial crisis. Import firms were also hurting because of the wild exchange rate fluctuations. The crisis' impact on the balance sheets of Chilean corporations had been relatively minimal. De Gregorio said the Central Bank had looked very carefully at private sector exposure to debt denominated in foreign currency and it was quite low. As a result of past history, especially during the crisis of the early 1980's, Chilean

companies had become averse to currency risk.

¶9. (C) The Ambassador asked about the effect of falling copper prices on Chile,s fiscal policy. De Gregorio noted many were calling on the GOC to re-work its proposed 2009 budget to account for the much lower copper prices. This was unnecessary in his view. The GOC had &saved so much8 of copper windfall profits in previous years that now it could run deficits at 2% of GDP for the next few years. He predicted Chile,s GDP would probably grow by 4% in 2009.

Chilean Politics: Don,t Count Concertacion Out  
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¶10. (C) De Gregorio noted that although the recent municipal elections had appeared to be a victory for the center-right Alianza, at heart the country remained pro-Concertacion (center-left). If the country elected Sebastian Pinera (RN) as its next president it would be because they were tired of the Concertacion, not because they had opted for a more right-wing ideology. He thought former President of the Christian Democrat Party (DC), Soledad Alvear - who had resigned in the aftermath of the elections - had known in advance that her party would fare poorly in the municipal elections. She had taken the noble step of seeing it through to the end despite the fact that she would likely be forced to resign and end her presidential aspirations. De Gregorio admitted he liked Jose Miguel Insulza (PS) as a candidate. He believed former President Ricardo Lagos (PS) was compromised by some of his administration,s policies, such as Transantiago (seen as a failure by most Chileans).

¶11. (C) COMMENT: We support De Gregorio,s request for a positive U.S. statement on Chile,s recent economic performance. Chile is looking for recognition that it has made the right economic choices in the past and has reacted well to the financial crisis (which it has). A statement from the U.S. could be a well-timed pat on the back to the GOC and a gesture of reassurance to the Chilean economy and

potential foreign investors.  
SIMONS